United States Court of Appeals

for the Second Circuit

BRIEF FOR APPELLEE

Court Copy

76-7235

To be argued by
RICHARD P. SHLAKMAN

United States Court of Appeals
For the Second Circuit

B
P/S

WINTHROP J. ALLEGAERT, as Trustee of duPont Walston Incorporated,
Plaintiff-Appellant,
against

H. ROSS PEROT, ELECTRONIC DATA SYSTEMS CORPORATION, duPONT GLORE FORGAN INCORPORATED, WILLIAM K. GAYDEN, MORTON H. MEYERSON, MILLEDGE A. HART, III, MARGOT PEROT, MERVIN L. STAUFFER, PHM & CO., CHARLESTON INVESTMENT COMPANY, E.D. SYSTEMS CORPORATION, NEW YORK STOCK EXCHANGE, INC., DANIEL J. CULLEN, WILLIAM D. FLEMING, GEORGE T. THOMSON and CHARLES W. COX,
Defendants-Appellees,
and

DOUGLAS E. DETATA, JOHN J. DOUGHTY, ALLAN BLAIR, and D. TIPP CULLEN,
Defendants.

On Appeal from the United States District Court for the Southern District of New York

BRIEF OF DEFENDANTS-APPELLEES
(other than the New York Stock Exchange, Inc.)

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UNITED STATES COURT OF APPEALS

For the Second Circuit

No. 76-7235

WINTHROP J. ALLEGAERT, as Trustee of duPont Walston Incorporated,

Plaintiff-Appellant,

against

H. ROSS PEROT, ELECTRONIC DATA SYSTEMS CORPORATION, duPONT GLORE FORGAN INCORPORATED, WILLIAM K. GAYDEN, MORTON H. MEYERSON, MILLEDGE A. HART, III, MARGOT PEROT, MERVIN L. STAUFFER, PHM & CO., CHARLESTON INVESTMENT COMPANY, E.D. SYSTEMS CORPORATION, NEW YORK STOCK EXCHANGE, INC., DANIEL J. CULLEN, WILLIAM D. FLEMING, GEORGE T. THOMSON and CHARLES W. COX,

Defendants-Appellees,

and

DOUGLAS E. DE TATA, JOHN J. DOUGHTY, ALLAN BLAIR, and D. TIPP CULLEN,

Defendants.

On Appeal from the United States Court for the Southern District of New York

BRIEF OF DEFENDANTS-APPELLEES
(Other than the New York Stock Exchange, Inc.)

ISSUES PRESENTED

1. Did the District Court, under the mandate of the United States Arbitration Act (9 U.S.C. §3), correctly stay the action commenced below by the trustee in bankruptcy against these defendants-appellees in favor of arbitration and thus enforce against the trustee three separate arbitration agreements to which the bankrupt was a party and which cover all disputes involving the bankrupt and these defendants-appellees?

2. Did the District Court correctly rule that certain of the trustee's claims, founded upon sections of the Bankruptcy Act and federal securities laws, should be arbitrated?

3. Did the District Court have authority under 9 U.S.C. §5 to provide an alternative mechanism for the selection of arbitrators, rather than preclude arbitration entirely, in order to enforce the applicable arbitration agreements?

4. Assuming, arguendo, that any of the trustee's claims are determined not to be arbitrable, did the District Court correctly stay all proceedings pending arbitration of the arbitrable claims?

PRELIMINARY STATEMENT

This is an appeal by Winthrop J. Allegaert (the "trustee"), the trustee in bankruptcy of duPont Walston Incorporated ("Walston"), from a Memorandum and Order entered below on April 14, 1976 (J.A. 400)* and a subsequent order entered on May 6, 1976 (J.A. 430) by District Judge Whitman Knapp.

The court below, pursuant to Section 3 of the United States Arbitration Act (9 U.S.C. §3) (the "Arbitration Act"), granted the motion made by 15 moving defendants (these appellees, as described in J.A. 72-73) to stay the action in favor of arbitration of all claims asserted against them; granted the motion made by defendant New York Stock Exchange, Inc. (the "NYSE") for a stay as to it pending arbitration of the claims against these 15 defendants-appellees; and directed the parties to agree among themselves upon the appropriate arbitration tribunal, in default of which the court below would designate the American Arbitration Association (the "AAA") as the arbitration tribunal (Opinion J.A. 419)**.

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* All references herein to the Joint Appendix are designated "J.A.", to the trustee's Brief are designated "Tr. Br.", and to Judge Knapp's Memorandum and Order are designated "Opinion" and are thereafter cited to the appropriate J.A. page.

** In the exercise of its inherent power to control its docket, the District Court also stayed the action as against four non-moving defendants as to whom the arbitration requirements also applied (Opinion, J.A. 419, 420 at note 1).

The District Court, in staying all proceedings in favor of arbitration, treated at length each of the contentions made and the authorities cited by the trustee and rejected them, expressly ruling in its Opinion that they were generally not persuasive (J.A. 402). Judge Knapp first rejected the trustee's underlying premise, embellished on this appeal, that a trustee in bankruptcy enjoys a "special status" as an entity separate from the bankrupt, which somehow immunizes him from the arbitration mandate of the Arbitration Act (Opinion, J.A. 407-08). Then the court proceeded to overrule each of the trustee's more specific contentions, holding that:

1. The power to reject executory contracts of the bankrupt under Section 70b of the Bankruptcy Act did not, as claimed by the trustee, relieve the trustee of the duty to arbitrate claims brought by him, finding that the "weakness in such a position is that it rests on a false assumption" and that the trustee's cases were "inapposite", since none of the relevant underlying contracts containing arbitration provisions were executory, and ongoing arbitration agreements did not render executory, otherwise non-executory contracts (Opinion, J.A. 407-09).

2. The trustee's claims to recover fraudulent transfers and voidable preferences under the Bankruptcy Act* were

* The trustee sued under many Delaware and New York common law and statutory theories, in addition to his federal statutory claims.

subject to arbitration, finding that the trustee's contentions to the contrary were "unsupported by the cases or considerations of public policy". (Opinion, J.A. 413-14).

3. The trustee must arbitrate his federal securities law claims because this is a dispute between present or former stock exchange members, finding that the trustee's contentions to the contrary fly "in the face of strong authority in this Circuit" and that his alleged policy considerations are "specifically contradicted by the cases" and Section 28(b) of the Securities Act of 1934 (Opinion, J.A. 414-16).

4. Section 5 of the Arbitration Act required the District Court to appoint substitute arbitrators, rather than relieve the trustee of his duty to arbitrate, where it might be inappropriate to follow the arbitration mechanism designated by the parties, finding that the trustee's assertions of bias of an applicable arbitration forum -- under the American Stock Exchange, Inc. (the "AMEX") Constitution -- were "belated", that his own conduct "undermines this argument" and that in all events the parties clearly intended to arbitrate in some forum (Opinion, J.A. 410-13).

Although the trustee advances here most of the same arguments rejected below, he has added a new emphasis. The trustee had urged upon Judge Knapp the contention that arbitration would be counter to public policy based upon a fear

that arbitrators would be "friendly" to the defendants and that arbitration would be prolonged and expensive. Judge Knapp correctly disposed of this "vague" assertion as lacking any factual support in the record and as being directly contrary to specific rulings of this Court and the national policy in favor of arbitration (Opinion, J.A. 414).

The trustee now expands his "vague" fear into a wholesale attack on arbitration in general, as if this Court were deciding the enforceability of arbitration clauses for the first time, _tabula rosa_. He seeks to have this Court overturn 50 years of uniform application of the national policies in favor of arbitration which flow directly from the Arbitration Act. Ignoring this national policy and the rulings of this Court applying it, the trustee has permeated his brief with the _ad hominem_ declarations that all arbitrators _are_: incapable of deciding the legal issues presented by the instant case (Tr. Br. 23); unconscientious (_id._ 25-26); "unresponsive and unresponsible to society in general" (_id._ 33); and "inexperienced" (indeed likely to be "occasional, part-time amateurs")(_id._ 35); who also _will_: refuse to follow the law and therefore will not embrace the Bankruptcy Act and the federal securities laws (_id._ 37-38); permit this case to be tried on affidavits (_id._ 37); try cases in Star Chamber proceedings so as to frustrate the alleged "great public interest" in this case (_id._ 38); and hide their failure to

reflect carefully and be analytically precise by not writing opinions (id. 38-39).*

Of course, there is no basis in the record (or elsewhere) to support this wholesale condemnation of arbitration.** Such a spurious attack flies squarely in the face of the "overriding federal policy favoring arbitration", Carcich v. Rederi a/b Nordie, 389 F.2d 692, 696 (2d Cir. 1968), a policy which has become "part of the warp and woof of the fabric of our jurisprudence," In the Matter of Blair & Co. (Cahn) 70 B 755 (S.D.N.Y., May 12, 1972) Slip Op. at p. 5 (J A. 353, 357), aff'd, by Brieant, J. (September 6, 1972) (J.A. 361).

Significantly, the attack on arbitration generally and the claimed exemption from arbitration based on the trustee's status are directly contrary to this Court's recent pronouncement in Truck Drivers Local Union No. 807 v. The

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* Indeed, the hyperbole gets so thick that he accuses the AAA and all of those individuals who give their time and effort to serve as arbitrators of participating in a calculated cover-up of their own ineptitude (Tr. Br. 38).

** The arguments proffered by the trustee are based not on precedent or policy, but in large part on tidbits quoted from commentators engaged in the exercise of advising as to the initial desirability, in various business contexts, of agreeing to contract clauses compelling arbitration of future disputes. Here, three arbitration agreements (set forth in full in the addendum to this brief) already existed prior to the time the disputes in issue arose.

Bohack Corp., Docket Nos. 75-7694, 76-3003 (2d Cir. August 9, 1976) (hereinafter "Truck Drivers") that a contractual "obligation to arbitrate, solemnly undertaken, is not subject to a unilateral disavowal" by a trustee and "survives the filing of a petition in bankruptcy" (Id. Slip Op. at 5175-76).

The trustee's shrill cry against arbitration -- a cry which invites this Court to return to the judicial dark ages when courts, jealous of their jurisdiction, condemned arbitration on every available basis* -- should again be rejected on the basis of this Court's own observation in Fallick v. Kehr, 369 F.2d 899, 903 (2d Cir. 1966), in a bankruptcy context, that:

> "judicial hostility to arbitration has not recently been characteristic of this court, properly so in the face of national policy favoring arbitration."

STATEMENT OF FACTS

The trustee sets forth what purports to be a "Statement of the Case" which has little bearing on any issue presented by this appeal (Tr. Br. 3-7). Rather, those "facts" merely restate, in summary form, the trustee's allegations made in his complaint, and represent an improper attempt to

* See Scherk v. Alberto-Culver Co., 417 U.S. 506, 510 and note 4 (1974); Erving v. Virginia Squires Basketball Club, 468 F.2d 1064, 1067-68 (2d Cir. 1972).

pre-litigate the merits of the underlying claims so as to color this Court's view of the only relevant issue on this appeal -- the duty to arbitrate. The same statement of "facts" was urged below, was properly ignored by Judge Knapp and should again be rejected by this Court as irrelevant.* When the merits of the case are reached in the appropriate arbitral forum, the "facts" alleged by the trustee will be vigorously, and, we believe, successfully controverted.

That portion of the trustee's "facts" which is not a mere lifting of the complaint, is not only incomplete, but in places is extremely misleading.**

The undisputed material facts, upon which Judge Knapp based his Opinion, are these. For many years Walston was a securities brokerage firm and a member of the NYSE, the AMEX and other securities exchanges (Opinion, J.A. 402). As such, Walston was bound by the Constitutions of the NYSE and the AMEX, including the comprehensive arbitration provisions

* The Court should note that the trustee admits that he has "no personal knowledge of the facts" (Tr. Br. 3).

** For example, without any citation to the record, the trustee makes the misleading statement that many of the claims are "concededly" not subject to arbitration (Tr. Br. 11). No such "concession" has ever been made by these appellees or inferred by the Court below as to them. The NYSE is the only litigant which is neither a party to nor a beneficiary of any arbitration agreement and which has never claimed it could require arbitration.

contained in each which require arbitration of _all_ controversies between it and exchange members and all controversies between it and nonmembers which arise out of its business (NYSE Const., Art. VIII, Sec. 1; AMEX Const., Art. VIII, Sec. 1) (Opinion, J.A. 406; 420, notes 3 and 4). In addition to Walston, twelve of the defendants below were also members or allied members of the NYSE and/or the AMEX at the time the relevant transactions took place (Opinion, J.A. 421 at note 6).

This action was commenced on July 1, 1975, by the trustee in bankruptcy of Walston* against twenty defendants, including fourteen individuals, five corporations and one partnership, asserting claims under federal and state securities laws, state statutory and common laws, and federal bankruptcy laws.** All of the claims arise out of and result from the July 2, 1973 realignment of the businesses of Walston and appellee duPont Glore Forgan Incorporated ("DGF Inc."), another brokerage firm which also was a member corporation of the NYSE and the AMEX (Opinion, J.A. 402). That realignment

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* Walston was declared a bankrupt on May 29, 1974.

** The trustee purports to state as a "fact" that while all defendants were served with discovery requests directed at them, no response was made thereto (Tr. Br. 8). The trustee neglects to note that on October 17 and 23, 1975 he stipulated in writing to stay all such discovery, pending the District Court's determination of defendants' motion to stay the action in favor of arbitration.

was accomplished pursuant to a series of agreements (the "Realignment Agreements") dated and effective as of July 2, 1973, whereby Walston assumed all front office operations of the two firms and DGF Inc. assumed all back office functions of the two firms, and both firms remained separate member corporations of the stock exchanges (Opinion, J.A. 402-3). In addition to the arbitration provisions in the NYSE and AMEX Constitutions, one of the Realignment Agreements (the Master Agreement) also contains a broad and comprehensive arbitration clause covering all disputes arising under the Realignment Agreements (Article 10.11 of Master Agreement to Realignment Agreements -- J.A. 117 -- quoted in the Opinion, J.A. 420, note 5).

Judge Knapp correctly described the complaint as alleging (a) that the defendants conspired to mislead Walston into approving the realignment transaction and executing the Realignment Agreements; (b) that DGF Inc. breached the Realignment Agreements; and (c) that certain of the defendants misappropriated Walston's assets in carrying out the Realignment Agreements, leading to Walston's financial collapse and ultimate demise (Opinion, J.A. 403-04). The claims arise directly from and involve only Walston's business as a brokerage firm before and after the realignment and arise only in connection with the business relationships and course of dealings pursuant to the Realignment Agreements among Walston, as

a stock exchange member corporation, and all of the other defendants (Opinion, J.A. 402-03).

The existence and breadth of the three applicable arbitration provisions demonstrate beyond peradventure the intention of Walston and the parties that dealt with it (except the NYSE) to arbitrate all the claims alleged in the complaint (see Opinion, J.A. 413, 422, note 10). Indeed, the trustee did not argue below and does not argue here that the instant disputes arose outside of the scope of any of the three arbitration clauses. Thus, this is not a case in which any question exists as to whether the parties agreed, given the broadest possible language of the applicable arbitration agreements, to arbitrate the disputes which have arisen. Rather, the trustee urged below and re-urges on this appeal a variety of reasons why those agreements should not be enforced against him. All such arguments lack merit.

ARGUMENT

Cutting across each of the trustee's arguments is the notion that arbitration is "bad" (supra at pp. 4-6); federal policy is to the contrary.

The federal policy favoring arbitration flows directly from Section 3 of the Arbitration Act,* which pro-

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* The full text of Sections 3 and 5 of the Arbitration Act are set forth in the addendum hereto.

vides that in <u>any</u> suit brought in <u>any</u> federal court upon <u>any</u> issue under a written arbitration agreement, the court <u>shall</u> stay the trial if it is satisfied that the issue involved is referrable to arbitration. When, as the District Court found below, the prerequisites of Section 3 have been met, a district court is <u>directed</u> to issue a stay pending arbitration. Whether or not to enforce arbitration contracts is not a matter of discretion; the language of 9 U.S.C. §3 is mandatory on its face, and should be liberally construed to effectuate the policy in favor of arbitration it espouses. <u>E.g.</u>, <u>Scherk v. Alberto-Culver Co.</u>, <u>supra</u>, 417 U.S. at 510-11; <u>Prima Paint Corp.</u> v. <u>Flood & Conklin</u>, 388 U.S. 395, 404 (1967); <u>Erving</u> v. <u>Virginia Squires Basketball Club</u>, <u>supra</u>, 468 F.2d at 1067-69; <u>Metro Industrial Painting Corp.</u> v. <u>Terminal Construction Co.</u> 287 F.2d 382, 385 (2d Cir. 1961). <u>See also</u> <u>Hamilton Life Ins. Co. of N.Y.</u> v. <u>Republic Nat. Life Ins. Co.</u>, 408 F.2d 606 (2d Cir. 1969).

Any doubts regarding arbitrability must be resolved in favor of arbitration. <u>Metro Industrial Painting Corp.</u> v. <u>Terminal Construction Co.</u>, <u>supra</u>, 287 F.2d at 385; <u>Robert Lawrence Company</u> v. <u>Devonshire Fabrics, Inc.</u>, 271 F.2d 402, 409-10 (2d Cir. 1959) , <u>cert. granted</u>, 362 U.S. 909, <u>dismissed under Rule 60</u>, 364 U.S. 801 (1960); <u>Incontrade, Inc.</u> v. <u>Oilborn International, S.A.</u>, 407 F.Supp. 1359, 1361 (S.D.N.Y. 1976); <u>Commonwealth Edison Co.</u> v. <u>Gulf Oil Corp.</u>, 400 F.Supp. 888,

890 (N.D. Ill. 1975); Singer Co. v. Tappan Co., 403 F.Supp. 322, 329 (D.N.J. 1975).

I.

A TRUSTEE IN BANKRUPTCY ENJOYS NO SPECIAL STATUS WHICH EXEMPTS HIM FROM ARBITRATION CLAUSES CONTAINED IN NON-EXECUTORY CONTRACTS OF THE BANKRUPT AND MUST ARBITRATE CLAIMS COVERED THEREBY WHICH HE INITIATES

The trustee presents three separate arguments to support his initial position that he cannot be compelled to arbitrate his claims, notwithstanding that he commenced the action below and that Walston was a signatory to three separate arbitration agreements which encompass the matters in dispute. The trustee argues that:

(a) simply because he is a juridical entity separate from the bankrupt, he cannot be bound by the arbitration agreements of the bankrupt -- his predecessor-in-interest (Tr. Br. 11-13);

(b) this overriding "power" to avoid arbitration is allegedly enhanced because a portion of his suit is to recover assertedly fraudulent transfers and voidable preferences under Sections 70e and 60b, respectively, of the Bankruptcy Act (11 U.S.C. §§110(e) and 96(b)) (id. 14-15); and

(c) in any event, each of the three arbitration agreements allegedly was "executory" at the time of the adjudication of Walston's bankruptcy, and was thereafter

"rejected" by the trustee, thus freeing him from the duty to arbitrate arising from those contracts (id. 16-26).*

But only last month in Truck Drivers, this court rejected these arguments, noting that "the contractual agreement to arbitrate survives the filing of a petition in bankruptcy" (Slip Op. at 5176).

A. A Trustee In Bankruptcy Will Be Compelled To Arbitrate Disputes When He Initiates The Action, Despite His Asserted Separate Identity From The Bankrupt.

The cornerstone of the trustee's argument that a bankruptcy trustee may not be compelled to arbitrate rests on the proposition that the trustee is a "juridical entity" separate from the bankrupt (Tr. Br. 9, 11-13). On this basis alone, regardless of whether or not the bankrupt's contracts are executory (and thus whether or not they are capable of rejection by the trustee), he claims that his special status immunizes him from the bankrupt's contractual

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* Included in this section of the trustee's brief is his first general assault on arbitration in general (id. 22-26). We do not intend to burden this brief with any extensive discussion of the merits of arbitration vis-a-vis litigation. Wholly apart from this Court's clear and repeated endorsements of arbitration, the thrust of the trustee's attack on the use of arbitration is to imply that the court below exercised (and abused) some discretion in staying the judicial proceedings in favor of arbitration proceedings. Of course, the court did no such thing -- no such discretion existed. See 9 U.S.C. §3.

duty to arbitrate. Contrary to the trustee's assertion, Judge Knapp did not treat the trustee and Walston "as if they were the same legal entity" (Tr. Br. 11); rather, the court below expressly took into account the trustee's claim of "special status", which purportedly permitted the exercise of some power, transcending his right to reject executory contracts, to avoid the bankrupt's arbitration agreements. That extraordinary power was correctly rejected below (Opinion, J.A. 407-08), and most recently by this court in Truck Drivers, supra.

It does not advance analysis regarding the trustee's duty to arbitrate to argue that the trustee and the bankrupt are different entities (Tr. Br. 11-13). Rather, assuming this separateness exists for some purposes,* the question is whether the trustee can be bound by agreements of the bankrupt to arbitrate disputes which are within the scope of the arbi-

* The trustee has cited no cases and we have found none, where the mere invocation of this "separateness" has become the basis for permitting trustee to avoid an obligation or duty of the bankrupt to arbitrate. Rather, the trustee's ability to avoid arbitration, if any, must flow from a specific -- and non-existent -- authorization contained in the Bankruptcy Act. By contrast, the cases are legion that accrued obligations generally of the bankrupt to third parties of various types and nature are binding on the trustee, notwithstanding that he is a new entity. E.g., Bank of Marin v. England, 385 U.S. 99, 101 (1966). Truck Drivers, supra, Slip Op. at 5177, Tobin v. Plein, 301 F.2d 378, 381 (2d Cir. 1962) and Schilling v. Canadian Foreign Steamship Co., 190 F.Supp. 462, 463 (S.D.N.Y. 1961), discussed infra, explicitly so state with respect to accrued arbitration obligations.

tration clauses when the trustee _initiates_ proceedings against alleged obligors of the estate. This question has squarely been answered "yes" -- the trustee is so bound. _E.g._, _Schilling_ v. _Canadian Foreign Steamship Co._, 190 F.Supp. 462 (S.D.N.Y. 1961). _See_, _e.g._, _Truck Drivers_, _supra_, Slip Op. at 5175-77; _Fallick_ v. _Kehr_, 369 F.2d 899 (2d Cir. 1966); _Tobin_ v. _Plein_, 301 F.2d 378 (2d Cir. 1962); _American Ship Building Co._ v. _Willy H. Schlieker, K.G._, 219 F.Supp. 905 (S.D.N.Y. 1963); _In re Grain Products Corp._, 20 F.Supp. 134 (S.D.N.Y. 1937); _In the Matter of Blair & Co. (Cahn)_, 70 B 755 (S.D.N.Y. May 12, 1972) (J.A. 353), _aff'd._, by Brieant J. (Sept. 6, 1972) (J.A. 361).

In _Schilling_, _supra_, the court asked

> "whether a trustee in reorganization who seeks to recover on a contract made with his debtor prior to the beginning of the reorganization proceeding may be compelled to proceed to arbitration in accordance with a provision in the contract." (190 F.Supp. at 462).

The answer was as follows:

> "The right of a party to a contract to resort to arbitration provided for in that contract is as much a contract right as is the right to payment ... The trustee by forcing [the defendant] to trial ... would be depriving [the party] of the right to arbitration for which it had bargained .... Bankruptcy does not, however, deprive the bankrupt's debtors of their rights." (_Id._ at 463).

This Court in _Truck Drivers_ expressly approved the result and reasoning of _Schilling_ -- ordering a trustee to

arbitrate over his objection -- stating that nothing in the Bankruptcy Act "'evince[d] a congressional policy that the trustee in bankruptcy shall have the right to abrogate agreements for arbitration,'" (Slip Op. at 5176) and that such "an obligation to arbitrate, solemnly undertaken, is not subject to a unilateral disavowal...." (*Id.* at 5175).

In *Truck Drivers*, this Court likewise approved its own prior ruling in *Tobin* v. *Plein*, *supra**, stating that *Tobin* stood for the proposition that a trustee can be forced to arbitrate since "a contractual agreement to arbitrate survives the filing of a petition in bankruptcy." (*Id.* at 5176).

Each of the cases in this Circuit enforcing arbitrations involving trustees has recognized a distinction between claims asserted *by* a trustee as opposed to claims asserted *against* a trustee. In the latter case, unlike the former, there is a potential for creation of a distribution preference among creditors of the estate. Thus, bankruptcy policy requires only that suits *against* the bankrupt estate shall lie in or under the supervision of one forum -- the bankruptcy court. No such policy, however, exists with respect to claims, as

* *Tobin* is discussed in detail *infra* at pp. 26-32.

here, brought by the trustee.* If arbitrated, they cannot create such a distribution preference.** The court below expressly adopted this rationale, relying on the cases in this Circuit, even before Truck Drivers was decided, holding that where the trustee "has been a plaintiff rather than a defendant, the courts have held that arbitration is appropriate" (Opinion, J.A. 409-10).*** The trustee fails to take

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* E.g., in American Ship Building Company, supra, and In re Grain Products, supra, arbitration was directed to proceed, over the objections of a trustee or debtor, because of the existence of binding agreements to arbitrate entered into by the predecessor-in-interest corporation, and because the arbitrator could not enter an award diminishing the assets generally available for the creditors of the estate or otherwise reordering the priorities of distribution to such creditors. The same would be true of arbitration in the instant case.

** Truck Drivers clearly involved this distinction in a case where a union sought to enforce against a debtor-in-possession a collective bargaining agreement. Arbitration with respect thereto, without bankruptcy court approval, would have adversely affected the rights of creditors, hence this Court ruled that bankruptcy court approval for arbitration was required under Bankruptcy Rule 919(b) and stated that it is the obligation of the bankruptcy court in such a case to protect creditors (Slip Op. at pp. 5178-79 and note 15). In the instant case, of course, unlike the situation in Truck Drivers where the union was present before the bankruptcy court, the trustee here sued outside that court in this plenary action. That is why no prior approval of the bankruptcy court under Bankruptcy Rule 919(b) is required for arbitration. By its own terms Rule 919(b) is not applicable to plenary actions, but is relevant only in courts of bankruptcy. Bankruptcy Rule 1 and Advisory Committee note thereto.

*** The court in Schilling expressly stated that it might not have ordered arbitration if the creditor were suing the estate; such a case would belong in the bankruptcy court since the very purpose of the proceeding is "to diminish the rights of the creditors" (190 F.Supp. at 463). See American Ship Building Co., supra, 219 F.Supp. at 907, (claims of "creditors are not diluted" by arbitration in a case brought by a trustee).

this rationale into account even though it underlies all the cases which he cites (Tr. Br. 12-13, 17-18, 40-41).

The three reported cases cited by the trustee* having anything to do with the issue of freeing bankruptcy trustees from arbitration agreements highlight the distinction between claims brought by rather than against trustees. This Court in Truck Drivers expressly observed as to two of these very cases that they belonged in the bankruptcy court so that such claims against the estate could be disposed of in one forum.**

* See In re Muskegon Motor Specialties Co., 313 F.2d 841 (6th Cir.), cert. denied, 375 U.S. 832 (1963); Johnson v. England, 356 F.2d 44 (9th Cir.), cert. denied, 384 U.S.961 (1966); Designer's Guild v. Hers Apparel Industries Inc., 76 CCH Lab. Cases ¶10,773 (S.D.N.Y. 1975). The distinction from the instant case involved in those cases -- claims brought against the estate, rather than suits brought by the trustee (as here) -- is well recognized. Kriendler, The Convergence of Arbitration and Bankruptcy, 26 Arb. J. 34, 38-39 (1971):

> "In both cases [Muskegon and Johnson], a determination in the arbitration would have affected the amount, existence and priority of claims to be paid out of the general funds and thus involved the interests of other creditors...."
>
> "Where, however, the courts have found that claims against the estate could be paid without diminishing the assets of the estate in the hands of the Trustee, arbitration has been compelled even over the objections of the Trustee."

** In Johnson, for example, it was held inappropriate to enforce arbitration against a trustee regarding a claim against the estate since that would amount to a "preference against other creditors of the bankrupt", although other claims would be appropriate for arbitration (356 F.2d at 52).

Significantly, the trustee can point to no distribution preference among creditors of this estate which could result from an arbitration as to the claims he is pressing against others.

This Court's decision in Fallick v. Kehr, supra, also disposes of the contention that a trustee may escape enforcement of the bankrupt's arbitration agreements. There, Judge Feinberg undertook a most thorough analysis of the duty to arbitrate in a bankruptcy context. His opinion clearly shows that nothing in the Bankruptcy Act evidences any hostility toward arbitration as an appropriate forum for the resolution of questions arising under that Act. Noting that "there is no policy evidenced by the Bankruptcy Act or precedent prohibiting an arbitrator from determining" bankruptcy issues (369 F.2d at 901), the court held that it could find nothing in the Bankruptcy Act that "grants the bankrupt an absolute right to choice of forum for determination of [such] questions" (id. at 904).

This Court in Fallick stated that an unswerving rule precluding arbitration of questions arising under the Bankruptcy Act "would have to be based on distrust of the arbitration process, or on an overriding policy of the Bankruptcy Act or on both (id. at 903)"; finding neither to be part of federal jurisprudence, it noted to the contrary that there are sections of the Act which actually "evince a recep-

tivity to arbitration ..." (id. at 904). That Court approvingly cited both Schilling, supra, and In re Grain Products Corp., supra, as cases in which arbitration of a dispute has been compelled "even when the trustee or debtor-in-possession has opposed it" (id. at 904).*

In short, without any authority supporting his position, the trustee would have this Court overthrow the "overriding federal policy favoring arbitration", Carcich v. Rederi a/b Nordie, 389 F.2d 692, 696 (2d Cir. 1968), merely because he is a trustee in a bankruptcy proceeding. But there is no hostility between the Bankruptcy Act and arbitration which requires any such result. Bankruptcy Judge Babitt (this

* The Second Circuit labor relations cases cited by the trustee (Tr. Br. 12) are inapposite to the proposition that the trustee enjoys a "special status", based solely on his separate identity, enabling him to walk away from arbitration agreements of the bankrupt. Bd. of Railway Clerks v. REA Express, Inc., 523 F.2d 164 (2d Cir. 1975), cert. denied, 423 U.S. 1017, 1073 (1976); Shopmen's Local 455, Bridge Workers v. Kevin Steel Products, Inc., 519 F.2d 698 (2d Cir. 1975). Neither case involved staying actions in favor of arbitration, nor the issue of whether or not a trustee can be compelled to arbitrate. This Court in Truck Drivers expressly recognized that these cases in no way obviated a trustee's duty to arbitrate (Slip Op. at 5176-77). Judge Feinberg, the author of Fallick, supra, posed the question in Kevin Steel (as in REA Express) to be only whether a debtor could reject an onerous, ongoing, admittedly executory collective bargaining agreement (519 F.2d 693, 700). Had Judge Feinberg meant his opinion in Kevin Steel to overrule or limit Fallick -- particularly his conclusion there that the Bankruptcy Act evidences "a receptivity to arbitration" -- we believe he would have expressly so stated. Of course, he made no such statement or gave any such indication.

estate's own bankruptcy judge) stated that bankruptcy disputes ought to be arbitrated since

> "the policy in favor of arbitration is based on a desire to eliminate expense and delay of protracted court proceedings. Trafalger Shipping Co. v. International Milling Co., 401 F.2d 568 (2d Cir. 1968). In any event, for whatever reason, the federal policy in favor of arbitration is part of the warp and woof of the fabric of our jurisprudence. Cf., Coenen v. R.W. Pressprich & Co., Inc., 453 F.2d 1209 (2d Cir. 1972). And any doubt that the policy is clearly applicable in bankruptcy proceedings is dispelled, not only by the plain agreement between the parties itself as here which this court recognizes, but also by this court's awareness that arbitration may be an appropriate method for resolving controversies between trustees or debtors-in-possession and others. See General Order in Bankruptcy 33." (Emphasis supplied).

In the Matter of Blair & Co. (Cahn), supra, at Slip Op. p. 5 (J.A. 357); accord, In the Matter of Blair & Co. (Danford), 70 B 755 at pp. 12-13 (S.D.N.Y., June 1, 1973) (J.A. 367 at 378-79).

B. Nothing In Sections 70e Or 60b Of The Bankruptcy Act Bolsters The Erroneous Contention That A Trustee Is Immune From Arbitration When He Seeks To Initiate Actions Against Other Parties To Applicable Arbitration Agreements.

The trustee's next contention (Tr. Br. 14-15) asserts that his alleged special immunity from arbitration (dealt with above in Point I.A.) is reinforced merely because he includes as part of his case, claims to recover alleged fraudulent transfers and voidable preferences under Sections 70e and 60b

of the Bankruptcy Act* brought in the name of "creditors".

In arriving at this contention, the trustee once again has stated an incontrovertible, but irrelevant, legal proposition (set forth below) and slips therefrom by non-sequitor to the illogical conclusion that a trustee who stands in the shoes of creditors can never be be compelled to arbitrate. Again, Truck Drivers put this contention to rest: "while... a debtor [in possession], as trustee, speaks for the creditor as well as itself, it may not abrogate a contractual obligation [to arbitrate] save by statutory or judicial permission" (Slip Op. at p. 5175).**

The trustee's two authorities cited for his contention stand only for a proposition as to which there is no quibble, to wit: that a trustee commencing actions under Section 70e and 60b of the Bankruptcy Act is given the status of a creditor of the bankrupt and, as such, certain defenses which could have been asserted against the bankrupt cannot be

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* The trustee later makes a substantially identical argument to the effect that such Bankruptcy Act claims are not arbitrable (Tr. Br. 26-41, rebutted infra at pp. 34-44).

** The court's citation to §313 of the Bankruptcy Act makes clear that by "statutory or judicial permission" it was referring only to rejection of admittedly executory contracts, not to some generalized (and non-existent) proceeding seeking to avoid arbitration duties under clearly non-executory contracts.

asserted against the trustee.* It does not follow, however, that anything in bankruptcy or any other law supports a conclusion that in asserting such claims, a trustee is not bound by the arbitration agreements of the bankrupt, and Truck Drivers holds that he is so bound.

Each and every trustee who has sought to avoid arbitration but was compelled to arbitrate by the cases discussed in Point I.A. above, has been vested with the same power to sue in the name of creditors under Bankruptcy Act Sections 70e and 60b. But that power, standing alone, simply does not permit the "unilateral disavowal" of arbitration agreements. Truck Drivers, supra, Slip Op. at 5175.

Again, as he did in the court below, the trustee confuses a statutorily created right (the right of a trustee to realize assets for the estate) with the issue of the forum in which that right is to be asserted (Opinion, J.A. 413).** See Fallick v. Kehr, supra, 369 F.2d at 904.

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* The trustee cites only two cases to support his novel contention of immunity from arbitration when asserting a Bankruptcy Act claim. Buttrey v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 410 F.2d 135, 139 (7th Cir.), cert. denied, 396 U.S. 838 (1969); Schneider v. O'Neal, 243 F.2d 914 (8th Cir. 1957). But they in no way involve the instant issue of whether a trustee possesses the power to avoid a duty to arbitrate where non-executory contracts containing arbitration clauses exist. Rather, they involve the true but irrelevant proposition that defenses relating to the misconduct of the bankrupt (which go to the merits of a trustee's action and which might have been asserted against the bankrupt) cannot be asserted against the trustee. Nothing in those cases involves arbitration at all or the question of the forum in which the trustee can be required to settle the dispute.

** As discussed infra at pp. 34-35, the trustee mistakenly urges that Section 70e and 60b Bankruptcy Act claims lie exclusively in a federal forum (Tr. Br. 41).

C. The Trustee Cannot Avoid Arbitration Under The Power Granted By Section 70b Of The Bankruptcy Act To Reject Contracts Since The Three Contracts Containing Arbitration Clauses Were Neither Executory Nor Rendered Executory By Reason Of The Continued Duty To Arbitrate.

The trustee repeats here his argument made in the court below that, under Section 70b of the Bankruptcy Act (11 U.S.C. §110(b)), he "rejected" the three separate arbitration agreements* of Walston and thus was relieved of any duty to arbitrate (Tr. Br. 16-26). Judge Knapp disagreed, holding that only executory contracts could be rejected and that none of the contracts containing the arbitration clauses constituted executory contracts (Opinion, J.A. 408). In order for a contract to be "executory", the court below correctly ruled that there had to be a "benefit or asset left for the Trustee to relinquish" and "performance left to be completed, at the time of the bankrupt's adjudication" (Opinion, J.A. 408, emphasis supplied). Finding first that no such benefit, asset or performance in futuro remained with respect to the underlying contracts in issue, Judge Knapp next flatly rejected the trustee's contention, made again here, that the inclusion in these otherwise non-executory contracts, of arbitration agreements that extend into the future could render such contracts executory (Opinion, J.A. 408-09).

* See Plaintiff's Memorandum In Opposition below at p. 7.

The trustee's theory of putative rejection of the arbitration agreements is nothing more than an attempt to repudiate an accrued choice of forum clause binding upon the bankrupt and its successors under contracts that were fully executed and performed prior to bankruptcy. A trustee is not permitted to reject such contracts under any section of the Bankruptcy Act.

Contracts which are no longer executory at adjudication of bankruptcy are not subject to rejection and are not even encompassed by the provisions of Section 70b. See, e.g., Truck Drivers, supra, Slip Op. at 5179, and note 15; Tobin v. Plein, 301 F.2d 378, 381 (2d Cir. 1962); Stell Manufacturing Co. v. Gilbert, 372 F.2d 113, 115 (5th Cir. 1966). To qualify as an executory contract at the time of adjudication of bankruptcy rejectable under Section 70b, the contract must call for some "performance in futuro" beyond the debtor's or bankrupt's mere obligation to pay for performance which has already been completed by the other contracting party. Crittenden v. Lines, 327 F.2d 537, 543 (9th Cir. 1964); In Re Forney, 299 F.2d 503, 507 (7th Cir. 1962).

The reason why a contract is no longer executory if no future performance is required emanates directly from the singular purpose underlying Section 70b. That purpose is to allow a trustee to disaffirm only those contracts which carry with them rights or assets of the estate plus burdensome and onerous obligations. The purpose is not to permit a trustee

to reject already accrued contractual* obligations or debts of the bankrupt. E.g., In re Grayson-R[illegible]binson Stores, Inc., 328 F.2d 500, 502 (2d Cir. 1963); In re Schulte Retail Stores Corp., 105 F.2d 986, 987-88 (2d Cir. 1939); Countryman, Executory Contracts in Bankruptcy: Part I, 57 Minn. L. Rev. 439, 451-463 (1973); (hereinafter "Countryman";) 4A Collier on Bankruptcy, ¶70.43, pp. 516-19.

Moreover, the law is abundantly clear that if a contract has either been terminated or materially breached prior to adjudication of bankruptcy, the contract ceases to be executory for purposes of Section 70b, even though the agreement to arbitrate continues. Tobin v. Plein, 301 F.2d 378, 381 (2d Cir. 1962) (if a prebankruptcy breach occurs, Section 70b will be wholly inapplicable as the contract will have ceased to be executory prior to adjudication of bankruptcy, and thus not within the statutory ambit of contracts subject to rejection). See also Truck Drivers, supra, Slip Op. at 5179 (rejection, which is deemed a breach as of the date of the filing of the petition, does not absolve either party, including the trustee, from duty the to arbitrate). Tobin is directly applicable here; termination or breaches indisputably had occurred prior to

* The NYSE and AMEX constitutional arbitration provisions are, of course, enforceable arbitration "contracts". See Brown v. Gilligan Will & Co., 287 F.Supp. 766, 769-70 (S.D. N.Y. 1968).

adjudication of Walston's bankruptcy.*

It was upon the basis of this unrebutted record of prior termination of all relevant contracts that Judge Knapp held that there was no remaining "performance in futuro" upon which to base a rejection under Section 70b. Even though an obligation to arbitrate continued beyond 60 days after Walston's

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* Judge Knapp found as a matter of fact from the record that all the contracts in issue had been completed or terminated prior to bankruptcy; the trustee did not dispute such findings below.

"On March 11, 1974 - 16 days prior to filing its petition under Chapter XI and 79 days prior to its adjudication as a bankrupt - Walston gave notice to the NYSE and AMEX that it was terminating its memberships. By May 1974 - the time of its adjudication - Walston had ceased doing any business under the rules of any exchange ...."

"... The same considerations apply with equal force to the arbitration clause in the Realignment Agreements, which by their own terms are written memoranda of a sequence of events and agreements already completed. Walston no longer had any obligation to perform <u>in futuro</u> thereunder, particularly in light of the fact that its entire business had disappeared long before adjudication." (Opinion, J.A. 408-09).

Moreover, pursuant to NYSE Constitution, Art. XIII, Sec. 2 and AMEX Constitution, Art. V, Sec. 3(a), Walston's memberships on these exchanges were suspended automatically upon its filing of its Chapter XI petition in March 1974. Even without regard to the terminations and suspensions discussed above, between February 1974 and its adjudication in May 1974, Walston closed or sold its entire branch office system and related assets and was no longer doing any business under the rules of any exchange (J.A. 343-44).

adjudication (and still exists), there was then no longer any asset or right attached to the obligation to arbitrate capable of being relinquished or thought too burdensome to be retained. To permit the trustee to avoid arbitration after Walston "received all the consideration for which [it] bargained", would be "relinquishing no benefits; he would merely be repudiating his obligations." In re Grayson Robinson Stores, Inc., supra, 321 F.2d at 502.

Tobin v. Plein, supra, directly puts to rest the trustee's contention that the arbitration clauses here were executory in the bankruptcy sense because they allegedly required some performance in futuro. Tobin stands squarely to the contrary -- a contract otherwise non-executory cannot be deemed executory by virtue of an arbitration agreement contained therein which extends into the future the obligation to arbitrate.* Moreover, even if a contract is executory and therefore rejectable, rejection "does not destroy the [parties'] . . . contractual duty to arbitrate their disputes." Truck Drivers, supra, Slip Op. at p. 5179, note 15.

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* Each of the trustee's asserted authorities to the contrary (Tr. Br. 17-18) is unavailing. Red Cross Line v. Atlantic Fruit Co., 264 U.S. 109 (1924) has nothing to do with a bankruptcy trustee's duty to arbitrate; the case was decided prior to the enactment of the Arbitration Act, thus the issue discussed there has not been a relevant one for 52 years. None of the other cases cited by the trustee deals with the issue of whether an arbitration clause revives an otherwise non-executory contract. The one state case cited by the trustee not involving an admittedly executory long-term collective bargaining agreement, Matter of Knickerbocker Agency, Inc. v. Holz, 4 N.Y.2d 245, 250 (1958), found that the New York Insurance Law vested "exclusive jurisdiction" over suits initiated by the Superintendent of Insurance in the state court. No parallel statute or policy exists in the instant case. Indeed, as discussed infra at pp. 34-35, there is no exclusive federal court jurisdiction as to any of the the trustee's claims.

The trustee suggests that Tobin did not hold that a contract terminated or breached prior to bankruptcy is no longer executory despite the inclusion of an arbitration agreement that extends into the future. He seeks to explain away Tobin (Tr. Br. 19-22) as a case in which this Court merely held that a trustee is vested by Section 70a(6) of the Bankruptcy Act (11 U.S.C. §110(a)(6)) with the bankrupt's right to sue or initiate arbitration against another party for breaches of contract occurring prior to bankruptcy, regardless of whether the contract in which such an arbitration clause exists has been rejected or assumed by the trustee. The trustee concludes that Tobin created a "statutory scheme" in which "a trustee in bankruptcy may force another party to arbitrate but cannot be compelled to arbitrate himself" (Tr. Br. 22). Such a reading of that case distorts its clear contrary holding.

This Court did state in the first part of Tobin that "any rights of action accruing to the trustee by virtue of prior acts in breach of such a contract should not be affected by the trustee's election or rejection under §70b" (301 F.2d at 381). That this quoted portion of Tobin (Tr. Br. 21) did not, however, establish the bizarre statutory scheme of law advanced by the trustee which would hold that the trustee can compel another to arbitrate but he cannot be so

compelled (allegedly by virtue of §70a(6) of the Act)* is disproved by the Tobin court's own statement in the same first part of that opinion, which the trustee fails to quote:

> "the trustee's failure to assume a contract under the statute would not relieve the bankrupt of obligations created by a breach committed before bankruptcy or by the fact of bankruptcy itself" (Id. at 381).

Thus, the entire premise upon which the Tobin court's partial statement relied on by the trustee (Tr. Br. 21) was made was that a trustee as much as anyone else is bound to arbitrate, regardless of Section 70(a)(6).

But the Court did not stop there. Instead, it expressly went on to hold that "a more fundamental consideration" was involved (a holding ignored entirely by the trustee): if there were a breach of the contract prior to bankruptcy, then Section 70b is wholly inapplicable "as the contract will have ceased to be executory prior to adjudication of bankruptcy, and thus not within the statutory ambit" (Ibid.).** It is this

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* The only authority cited by the trustee for his Section 70a(6) argument totally undermines his position. While the article relied upon by the trustee (Tr. Br. 20-21) does state that the right to receive goods already paid for by the bankrupt passes to the trustee automatically, and the trustee can either accept or abandon such property rights, the reason this is so is because such a contract is no longer executory. Countryman at 458-59.

** The Court then specifically held that since it was not clear when the breach of contract had occurred, any final determination of the effect of §70b would have to be determined in arbitration (Ibid.). Here, of course, the record is clear and the trustee has not disputed that the contracts in issue all terminated prior to bankruptcy (see supra at p. 28 and note 1).

latter "more fundamental" part of the Tobin opinion which the court below did not ignore and which disposes of the trustee's claim that the arbitration agreements themselves were still executory because the arbitration has not yet been held.

Subsequent to Tobin v. Plein, this Court has twice made it clear that in the context of a bankruptcy proceeding arbitration agreements are not merely rights of action of the bankrupt which pass only to a trustee under Section 70a(6) of the Bankruptcy Act and which (according to the trustee) enable him to arbitrate or not as his whim. Rather, an arbitration agreement creates a duty which binds a trustee. Truck Drivers, supra, Slip Op. at 5175-76 and Fallick, supra, 369 F.2d at 903-04.

* * *

As noted above we do not undertake to argue the respective merits or demerits of arbitration, a Rubicon which this Court has crossed many times contra to the trustee's position. We are constrained only to note with respect to the trustee's attack on arbitration in the guise that the anticipated expenses and delays in the "big case" allegedly make arbitration clauses "burdensome" (Tr. Br. 23-26)*, that con-

* The trustee overlooks Judge Knapp's injunction to the parties to agree among themselves upon the arbitration tribunal, only failing which would the AAA become that tribunal (Opinion, J.A. 419). The trustee fails to tell the court that he refused even to discuss with defendants following issuance of the Opinion (and without prejudice to his appeal) the question of selecting arbitrators.

sideration by this or any court of the factors iterated by the trustee would necessarily lead to a different conclusion as to the right of parties to compel arbitration involving bankrupts, depending upon whether the dispute is "big" or "little". No party to the arbitration agreements here agreed to arbitrate only their "little" disputes; they agreed to arbitrate "any" and "all" disputes and they made this agreement on no less than three separate occasions. There is obviously no basis in precedent or policy for the adoption of the type rule urged: that a trustee is free to reject and thus avoid an arbitration obligation undertaken by the bankrupt if his dispute with the other party to that arbitration agreement is "a big case", although he is bound to that obligation in a less complex controversy.

II.

THE TRUSTEE'S STATUTORY CLAIMS ARISING UNDER THE BANKRUPTCY ACT AND THE FEDERAL SECURITIES LAWS ARE ARBITRABLE

The trustee's complaint contains counts based upon the Bankruptcy Act to recover alleged fraudulent transfers and voidable preferences, and other counts based upon the federal securities laws to recover damages allegedly resulting from the sale of securities. The trustee argues that regardless of the binding effect of the bankrupt's arbitration agreements covering all his state law claims in this case, he cannot be bound to arbitrate such federal statutory claims. The court

below specifically and correctly rejected this contention with respect both to the bankruptcy and securities law claims (Opinion, J.A. 413-416).

A. The Trustee's Claims Alleging Fraudulent Transfers And Voidable Preferences Are Arbitrable.

The trustee characterizes the decision of Judge Knapp that the Section 70e and 60b claims of the trustee are arbitrable as being "wholly without precedent" (Tr. Br. 27). But as shown below, Judge Knapp was not writing on a clean slate.

The trustee bases his contention that Bankruptcy Act claims are non-arbitrable on the premise that "Congress placed the responsibility of deciding Bankruptcy Act cases in the federal courts; that is where this action belongs." (Tr. Br. 41). On the basis of that premise, the trustee argues that only federal judges and not arbitrators can decide claims arising under the Bankruptcy Act and that a trustee has an unencumbered right to choose a federal forum with respect to such claims (*id.* 27-40). The trustee's premise is plainly based upon a mistaken statement of law, and his conclusions that flow therefrom are equally erroneous.

The trustee fails to note that the Bankruptcy Act expressly provides for concurrent jurisdiction in *state* courts to hear plenary actions, such as this one, brought by a trustee pursuant to the very Bankruptcy Act sections sued under

here. 11 U.S.C. §96(b) [Bankruptcy Act §60b claims]; 11 U.S.C. §107(e) [Bankruptcy Act §67e claims]; 11 U.S.C. §110(e) [Bankruptcy Act §70e claims]. 3, 4 and 4A Collier on Bankruptcy ¶¶60.60, 67.44&44[4] and 70.91.

Judge Feinberg's opinion in Fallick v. Kehr, supra, is the appropriate starting point to demonstrate the correctness of the court's decision below with respect to requiring arbitration of issues arising under the Bankruptcy Act. Given the duality of federal and state jurisdiction as to certain Bankruptcy Act claims, this Court in Fallick stated that: "arbitration . . . with its speedy and economical procedures seems no less appropriate than litigation in a state court" (369 F.2d at 905). Fallick was directly in point when decided, because the issues of a bankrupt's discharge involved in Fallick were then (as the 70e and 60b claims still are here) subject to dual federal and state jurisdiction. As we shall see, the rationale of Fallick has become even stronger precedent based upon subsequent congressional action.

Fallick clearly shows that nothing in the Bankruptcy Act evidences the hostility, manufactured by the trustee, toward arbitration as the appropriate forum for the resolution of questions arising under that Act. The Fallick court stated that an unswerving rule precluding arbitration of questions arising under the Bankruptcy Act "would have to be based on distrust of the arbitration process, or on an overriding policy

of the Bankruptcy Act or on both." The court could find no such distrust or overriding policy. Indeed, the court rejected the same contention that arbitration could not resolve "federal statutory causes of action" (Tr. Br. 28, 41),* specifically noting both the "national policy favoring arbitration" and the Bankruptcy Act section dealing with arbitration of controversies "arising in the settlement of the estate". The court found that the Act "evinces a receptivity to arbitration ..." 369 F.2d at 904. Accord, In the Matter of Blair & Co. (Cahn), supra (J.A. 357); In the Matter of Blair & Co. (Danford), supra (J.A. 378-79).

Even a cursory reading of Fallick indicates that the trustee's efforts to confine that decision merely to the arbitrability of the question of a bankrupt's discharge (Tr. Br. 29-30) is totally alien to the scope of the decision. And, far from eliminating the value of Fallick as a precedent, the 1970 amendment of Section 17c of the Bankruptcy Act (11

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* Fallick made reference not only to the Arbitration Act governing irrevocable agreements to arbitrate disputes in all commercial transactions, but also took note of many other federal statutes compelling or permitting arbitration of statutory claims, such as 22 U.S.C. §2395(i) (arbitration of claims arising out of investment guarantee operations); 29 U.S.C. §108 (arbitration as prerequisite to injunctive relief in labor disputes); 29 U.S.C. §186(c)(B) (arbitration of union trust funds disputes); 28 U.S.C. §2677 (arbitration of tort claims against the Government); 46 U.S.C. §§749, 786 (arbitration of admiralty claims against the Government); and 41 U.S.C. §113(e) (arbitration of war contracts claims). 369 F.2d at 903, at note 6.

U.S.C. §35(c)), rendering certain discharge questions subject to exclusive federal jurisdiction, demonstrates clearly that when it wishes to do so, Congress knows how to confine claims (including certain bankruptcy claims) to exclusive federal or bankruptcy court jurisdiction. Notably, Congress has not done so with respect to Section 70e or 60b bankruptcy claims -- the relevant sections in this case.* The bankruptcy claims asserted here, unlike exclusively federal discharge claims, are not affirmative claims brought by creditors against the bankrupt, but rather are actions brought by the trustee to recover allegedly fraudulent and voidable transfers. Since Section 70e and 60b actions may be heard in (1) bankruptcy court (assuming that jurisdiction exists over defendants -- not the case here); or (2) federal district court in a plenary action; or (3) state court in a plenary action (4A Collier on Bankruptcy ¶70.91, p. 1043), no federal policy can be said to exist which would prevent deciding such claims also in arbitration. To the contrary, the legislative history cited by the trustee (Tr. Br. 30) indicates quite clearly that in amending Section 17c, Congress never addressed the issue of arbitrating plenary suits such as this one, and the word "arbitration" is never

* Significantly, Congress has carved out for exclusive treatment in bankruptcy court other sections of the Bankruptcy Act (*e.g.*, §§60d and 67a(4)).

mentioned in the report (2 U.S. Code Cong. & Admin. News 4163 (1970)).

Courts have had no trouble in holding that claims arising under federal statutes must be arbitrated. In addition to Fallick, examples of such cases are: United States for use of Capolino Sons, Inc. v. Electronic & Missile Facilities, Inc., 364 F.2d 705 (2d Cir. 1966)(arbitration was ordered on a claim under the Miller Act); Donahue v. Susquehanna Collieries Co., 138 F.2d 3 (3rd Cir. 1943); Beckley v. Teyssier, 332 F.2d 495 (9th Cir. 1964); Evans v. Hudson Coal Co., 165 F.2d 970 (3d Cir. 1948)(arbitration was approved for damage claims under the Fair Labor Standards Act); Cavicchi v. Mohawk Manufacturing Co., 34 F.Supp. 852 (S.D.N.Y. 1940) (estoppel effect given to a confirmed arbitration award that decided questions of patent infringement between the parties). See also the cases approvingly cited by Judge Feinberg in Fallick, 369 F.2d at 904-905; and the many cases requiring broker-dealers to arbitrate claims under the federal securities laws cited in Point III.B., infra at pp. 44-50.

The trustee offers no reason, and we perceive of none (other than his erroneous view of "exclusive" federal jurisdiction), why as a matter of policy federal claims cannot be arbitrated. Requiring the trustee to submit his Section 70e and 60b claims to arbitration where, as here, such claims relate only to the business of Walston as a broker-dealer and

thus are clearly within the scope of arbitration clauses agreed to by the bankrupt, would be no different than requiring any trustee to arbitrate any claim over his objection. As the Fallick court noted approvingly of Schilling, supra, that was a case "in which arbitration of a dispute" was compelled "even when the trustee ... had opposed it" (369 F.2d at 904). The trustee attempts to distinguish Schilling by the truism that it "was a suit by a trustee on a contract which he had affirmed" (Tr. Br. 31). But in so doing the trustee has confused the issue of whether the contract is executory (as the ones here clearly are not), with the issue of whether statutory, among many other, claims should be arbitrated. All of the above cases show that they should be.

The cases cited by the trustee (Tr. Br. 32) are unavailing. The trustee is unable to point to any absolute and unqualified right to a federal forum which overrides the duty to arbitrate with respect to the claims raised here. All but one of his cases arose under a specific statutory scheme expressing an absolute and unqualified right to have claims arising thereunder adjudicated exclusively by a federal court (see Opinion, J.A. 422 at note 13): Wilko v. Swan, 346 U.S. 427 (1953) (a customer agreement to arbitrate with broker-dealers is a forbidden advance waiver of the customer's rights

expressly protected by the Securities Act of 1933);* Alexander v. Gardner-Denver Co., 415 U.S. 36 (1974) (no hostility toward arbitration as a matter of public policy; rather one who arbitrated certain issues arising under the Equal Employment Opportunity Act of 1972 could nevertheless litigate the discrimination issues involved in his discharge from employment); American Safety Equipment Corp. v. J.P. Maguire & Co., 391 F.2d 821, 827 (2d Cir. 1968) (antitrust case not arbitrable, but this Court carefully noted that its decision was not to be read as "general distrust of arbitrators or arbitration; our decisions reflect exactly the contrary point of view");** U.S. Bulk Carriers, Inc. v. Arguelles, 400 U.S. 351 (1971) (direct conflict between two federal statutes -- §301(a) of the Labor Management Relations Act, 29 U.S.C. §185(a), and 46 U.S.C.

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* Indeed, the majority opinion of the Supreme Court in Wilko stated:

> "The United States Arbitration Act establishes by statute the desirability of arbitration as an alternative to the complications of litigation. The reports of both Houses on that Act stress the need for avoiding the delay and expense of litigation, and practice under its terms raises hope for its usefulness both in controversies based on statutes or on standards otherwise created." 346 U.S. at 431-432 (emphasis supplied, citations omitted).

** In that case this court took specific note of its own decision in Fallick permitting arbitration of claims arising under the Bankruptcy Act, stating that the arbitrability of antitrust claims posed a different issue (id. at 825).

§596 -- the latter grants seamen an express statutory right to have certain claims for wages decided by a federal court).

L.O. Koven & Brother, Inc. v. Steelworker's Local 5767, 381 F.2d 196 (3d Cir. 1967) is the only case cited by the trustee not arising under an express statutory scheme providing for an exclusive federal forum; Koven affords him no aid. There, during the course of a Chapter XI proceeding, the debtor, Koven, had compromised a claim brought against it by the union representing Koven's employees. Koven had also received a general release from the union. Following the conclusion of the Chapter XI proceedings, the union submitted a vacation pay claim to Koven. This was a different claim than those which had been compromised and settled in the Chapter XI proceedings, but it involved claims for vacation pay based, in part, on services rendered during the period prior to the termination of those proceedings. In Koven, the Third Circuit held that the issues of whether the union's claims had been released and, if not, the amount due from Koven to the union members should be decided by arbitrators under the applicable arbitration provision, and the issue of whether there had been a discharge in a Chapter XI proceeding, as claimed by Koven, should be decided by the District Court (Id. at 204-05).*

* This was the same narrow issue that had been presented in Fallick supra, and an issue which Congress has now placed exclusively in the hands of bankruptcy courts. Bankruptcy Act, Section 17c, 11 U.S.C. §35(c).

The Koven court held that the "discharge" issue simply was not within the ambit of the applicable arbitration clause in the collective bargaining agreement which was strictly limited to labor issues. Following this holding, the court in dictum stated that it was impelled to its decision because of the unreviewability of arbitrators' decisions, a factor which that court believed to be in conflict with the policy favoring "uniform application and development of federal bankruptcy policy" (381 F.2d at 201).

In so stating, that court went squarely contrary to the views of this Court in Fallick v. Kehr, supra, regarding the policy of arbitrating bankruptcy claims.* The Third Circuit, however, instead of explaining its disagreement with Fallick called it "readily distinguishable since the contractual submission [to arbitration in Fallick] was for the determination of all matters, not merely labor matters ...." 381 F.2d at 201, note 16.

Here, of course, "any" and "all" disputes were to be arbitrated.** Based on this distinction in the scope of

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* The Koven court did not engage in any of the detailed analysis of the issue which characterizes Judge Feinberg's majority opinion in Fallick. No consideration was given by the Third Circuit to the cases cited in Fallick which had held that bankruptcy trustees could be compelled to arbitrate against alleged debtors of the estate where, as here, the bankrupt had so agreed contractually and the trustee commenced the suit.

** The trustee argues that Walston's execution of the NYSE and AMEX arbitration contracts was not "a product of free choice" since exchange membership was required for it to conduct its business (Tr. Br. 34). But this Court expressly
(Footnote Cont'd)

the applicable arbitration clauses, even the Koven court would agree that arbitration of the instant claims is compelled by the decision of this Court in Fallick. Indeed, this Court in Truck Drivers, recently cited Koven for the proposition that the duty to arbitrate is not subject to a unilateral disavowal after bankruptcy (Slip. Op. at p. 5175).

The trustee contends here that the statutory rights he seeks to assert and the suitability of arbitration as a forum for vindicating those rights must be carefully examined, and he criticizes Judge Knapp for failing to undertake this "required" analysis (Tr. Br. 31). If there was any failure below, it was the trustee's, since he failed to advise the court of any reason why arbitration was an unsuitable forum for enforcing rights created by Sections 60b and 70e of the Bankruptcy Act.* As Judge Knapp found:

(Footnote Cont'd)
rejected this type of "unfair bargaining position" argument when made by another brokerage firm with respect to the arbitration provisions of the exchange constitutions. Axelrod & Co. v. Kordich, Victor & Neufeld, 451 F.2d 838 (2d Cir. 1971). See also Rust v. Drexel Firestone Inc., 352 F.Supp. 715 (S.D.N.Y. 1972). Moreover, the trustee fails to offer any explanation as to why the arbitration agreement contained in the Realignment Agreements was not a "product of free choice".

* The trustee has not properly addressed himself to Judge Knapp's proper reliance upon the express provision in the NYSE Constitution for arbitration of disputes involving "dissolution" of member firms as a ground upon which to base the holding that Bankruptcy Act claims involving broker-dealers are arbitrable (Opinion, J.A. 414).

"[t]he only argument the Trustee can muster in support of his rather vague contention that arbitration would be counter to 'public policy' is his fear that somehow an arbitratation tribunal would be 'friendly' to the defendants" (Opinion, J.A. 414).

Again here the trustee expands his "unfriendly arbitrators" argument into yet another attack on the entire process of arbitration and the men who perform that task. This Court, as noted, does not share the trustee's "general distrust of arbitrators or arbitration". American Safety Equip. Corp. v. J.P. Maguire & Co., supra, 391 F.2d at 827. See also Fallick v. Kehr, supra, 436 F.2d at 904.

B. The Trustee's Securities Law Claims Are Arbitrable.

The trustee argued below that the federal securities law claims asserted in his complaint were not subject to arbitration. He failed to convince Judge Knapp to ignore the clear language and the basic scheme of the securities laws, as well as every relevant case decided on the issue, all of which mandate that stock exchange member firms like Walston are required to arbitrate disputes arising under the federal securities laws (Opinion, J.A. 414-16, 422 at note 14). The trustee tries again here to have this Court rewrite the securities laws and to overrule its prior holdings regarding the regulation of broker-dealers and the duty to arbitrate securities laws questions involving them (Tr. Br., 41-46).

The trustee's principal reliance here, as below, is

on Wilko v. Swan, 346 U.S. 427 (1953), which held that the arbitration clause contained in a margin agreement signed by a customer of a brokerage firm was void when signed under §14 of the Securities Act of 1933 (15 U.S.C. §77n), as an improper advance waiver of the customer's rights under §22 (15 U.S.C. §77v) of that Act. Subsequent cases extending the Wilko principle to claims arising under the Securities Exchange Act of 1934 have similarly based their holdings upon the almost identically worded non-waiver provision protecting customers in Section 29(a) of that Act (15 U.S.C. §78cc(a)).*

Every relevant case in this Circuit has held, however, that the Wilko principle does not apply where, as here, an arbitration agreement is sought to be enforced against a member firm of a stock exchange pursuant to an arbitration requirement in exchange rules.** All of these cases observe

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* The Supreme Court has recently cast some doubt as to the applicability of Wilko v. Swan to the implied private right of action founded upon Rule 10b-5, sued upon here. Scherk v. Alberto-Culver Co., supra, 417 U.S. at 513-14.

** Coenen v. Pressprich & Co., 453 F.2d 1209, 1214 (2d Cir. 1972); Axelrod & Co. v. Kordich, Victor & Neufeld, 451 F.2d 838 (2d Cir. 1971); Brown v. Gilligan Will & Co., 287 F.Supp. 766, 771-774 (S.D.N.Y. 1968); Rust v. Drexel Firestone Inc., 352 F.Supp. 715 (S.D.N.Y. 1972); Reich & Co. v. Imperial Investment Corp., CCH Fed. Sec. Rep. ¶93,437 (S.D.N.Y. 1972) (not officially reported). See also In re Revenue Properties Litigation Cases (Cohn, Delaire & Kaufman), 451 F.2d 310 (1st Cir. 1971); Legg, Mason & Co., Inc. v. Mackall & Coe, Inc., 351 F.Supp. 1367 (D.D.C. 1972).

that in disputes involving exchange members (like Walston and DGF Inc. and the majority of other defendants who at all relevant times were exchange members), enforcing the arbitration provisions of the exchange constitutions or the arbitration clauses contained in agreements between the parties is fully consistent with the underlying policies reflected in Wilko.

However, the inappositeness of the policy considerations underlying Wilko is not the primary reason offered by the courts for requiring an exception to Wilko where arbitration is sought against a member or former member of an exchange. More importantly, this exception to Wilko has been squarely founded on a specific provision of the securities laws -- Section 28(b) of the 1934 Act -- which is intended to effectuate a fundamental purpose of the securities laws to promote self-regulation by the exchanges.

The basis for exchange self-regulation is well known to this Court. Indicating the importance of exchange self-government, Section 28(b) (15 U.S.C. §78bb(b))* expressly preserves the validity of exchange rules for settlement of disputes by arbitration between members, regardless of any of the other provisions of the Act.

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* Section 28(b) provides:

> "Nothing in this chapter shall be construed to modify existing law with regard to the binding effect (1) on any member of or participant in any self-regulatory organization to settle disputes between its members ..."

In recognition of this state of the law, the trustee for the first time raises here an argument not made to the court below -- that Section 28(b) is no longer applicable to this case because Walston and the appellees who were exchange members at the time that the transactions in suit arose, are now no longer exchange members (Tr. Br. 44-45).

This totally unsupported and self-contradicted argument (see supra, p. 45 and note 2) would transmute the reason for the Wilko doctrine -- customer protection, whereby customer arbitration agreements cannot be enforced ab initio -- into a fluid doctrine, whereby exchange member arbitration agreements may become unenforceable depending on later intervening events. The entire thrust of Wilko -- that under certain circumstances a party will not be allowed to agree to arbitration in advance -- is totally inconsistent with the trustee's shifting sands approach.* Nothing in this or any case remotely supports such an application of the Wilko doctrine; the law is to the con-

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* The result which the trustee apparently seeks -- application of Wilko on a case-by-case basis, depending on whether or not the broker-dealer is still in business, or exchange memberships have ended or other after the fact contingencies peculiar to a case exist -- would subject the judicial system to a flood of new cases, since the enforceability or non-enforceability of arbitration agreements concerning securities law claims would always be subject to doubt. This approach and its consequences were specifically rejected in Gilligan Will, supra.

trary.* The trustee's argument was directly rejected in Matter of Blair (Danford), supra, Slip Op. at pp. 19-23 (J.A. 385-89), where Bankruptcy Judge Babitt permitted arbitration of securities claims between two former broker-dealers, one of which was in reorganization.

Pursuant to Section 28(b), the arbitration clauses in the exchange constitutions were not void ab initio when Walston and 12 of the defendants agreed to their terms by becoming exchange members. There was, in such acceptance of exchange memberships and the agreements to be bound by the exchange constitutions, and in the later agreement to arbitrate in the Master Agreement, no impermissible waiver of compliance with Section 14 of the 1933 Act or Section 29(a) of the 1934 Act. Simply put, the statutory restrictions on the freedom of customers to contract which were the foundation for Wilko simply

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* The trustee's view that the policies requiring that an exchange member submit to arbitration are inapplicable where the party resisting arbitration has resigned its membership or is in bankruptcy or liquidation has been specifically contradicted by a host of cases compelling former exchange members to submit to arbitration. E.g., Muh v. Newburger, Loeb & Co., Civ. No. 74-2733 (9th Cir. July 8, 1976); Isaacson v. Hayden Stone, Inc., 319 F.Supp. 929, 930 (S.D.N.Y. 1970); Muh v. Risher, 38 N.Y. 2d 441 (1975); Osborne & Thurlow v. Hirsch & Co., 10 Misc.2d 225, 226 (Sup. Ct. N.Y.Cty. 1958); and other state cases cited infra at p. 56. See Kastanias v. Nationwide Auto Transporters, Inc., 390 F.Supp. 720 (W.D. Pa. 1975); Zenol, Inc. v. Carblox, Ltd., 334 F.Supp. 866, 868-69 (W.D.Pa. 1971); Batson Y. & F.M. Gr. Inc. v. Saurer-Allma GmbH-Allgauer M., 311 F.Supp. 68, 71-72 (D.S.C. 1970). The case of Ayres v. Merrill Lynch, Pierce, Fenner & Smith, Inc., CCH Fed. Sec. L. Rep. ¶95,643 (3d Cir. 1976), cited by the trustee (Tr. Br. 44), neither deals with or casts any doubt upon a former member's duty to arbitrate disputes arising out of its exchange membership.

do not exist when applied to Walston and the other exchange members, and their contracts should be honored. As stated in Gilligan Will, an agreement between members of an exchange to arbitrate "resulting as it does from a valid exercise of exchange regulatory power, is entitled to the protection which Congress saw fit to provide in §28(b)" of the 1934 Act. 287 F.Supp. at 775. The Ninth Circuit recently disagreed with the trustee's reliance on former exchange membership as allegedly changing duties to arbitrate, stating: "It would seem strange indeed that with such a significant integrated method of dispute settlement one party could frustrate the purpose of the Exchange rules and the federal policy favoring arbitration by the mere expediency of resignation from the Exchange." Muh v. Newberger, Loeb & Co., Slip Op. at p. 4, Civ. No. 74-2783 (9th Cir. July 8, 1976); See Muh v. Risher, 38 N.Y. 2d 441, 444 (1976).

Appellant's contention that Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Ware, 414 U.S. 117 (1973) "undercut" the line of cases in this Circuit starting with Gilligan Will (Tr. Br. 44, 45-46) is far-fetched. That case involved what the Supreme Court viewed as the "housekeeping" nature of NYSE Rule 347(b) requiring arbitration of wage disputes between member firms and their employees (414 U.S. at 135). Ware did not involve: securities act claims; Section 28(b); member-member disputes; or the NYSE constitutional requirements for

arbitration between member firms. Rule 347(b) is not involved in this case and enforcement of the Exchanges' arbitration provisions in their Constitutions is a primary policy underlying Section 28(b).*

Hence, nothing the trustee has cited detracts a whit from this Court's description of the member-member arbitration requirements of the NYSE Constitution as "the most significant of the measures taken to implement the self-regulation contemplated by the 1934 Act." Coenen v. R.W. Pressprich & Co., supra, 453 F.2d at 1215 (emphasis supplied).

III.

THE DISTRICT COURT PROPERLY EXERCISED ITS POWER TO APPOINT SUBSTITUTE ARBITRATORS IN ENFORCING ALL THREE BINDING ARBITRATION AGREEMENTS

The trustee contends that none of the three arbitration agreements would have bound Walston, and thus none is enforceable against the trustee, because Judge Knapp allegedly (i) lacked power to appoint substitute arbitrators (Tr. Br. 47-53); and (ii) committed "clear error" in concluding that he had the power to enforce in any manner the arbitration clause

* Ayres v. Merrill Lynch, Pierce, Fenner & Smith, Inc., supra, like Ware is another employer-employee wage case arising under Rule 347(b). The Third Circuit there cited with approval the holdings in this Circuit regarding the applicability of Section 28(b) to member-member disputes, while contrasting the considerations applicable to arbitrating employee wage disputes (CCH Fed. Sec. L. Rep. at 90,185-87).

contained in the Master Agreement (Tr. Br. 48, note 2). Neither contention has any merit.

A. The District Court Had The Clear Power And The Statutory Obligation to Appoint Substitute Arbitrators.

These appellees voluntarily conceded below in the motion for a stay in favor of arbitration that because the NYSE is a defendant in the instant case, it would not be the appropriate forum under whose auspices the arbitration should be held, so as to avoid even the appearance of bias (Opinion, J.A. 411).

Thereafter, in responding to the motion to stay in favor of arbitration, the trustee claimed that the AMEX was also potentially biased. The court below rejected that contention as unsupportable, finding the claim to be "belated" and that "the Trustee's failure to sue the Amex [as he has sued the NYSE] undermines this argument" (Opinion, J.A. 411). After finding that no bias existed concerning arbitration under the AMEX Constitution and that the AMEX constitutional provision for arbitration was clearly applicable to the dispute, the court below nevertheless followed the mandate of Section 5 of the Arbitration Act to appoint substitute arbitrators, stating:

> "[s]o as to avoid even the appearance of bias which designation of the Amex might engender, the parties are directed to agree among themselves upon the appropriate arbitration tribunal, in default of which, the Court will, in accordance with the spirit of the Amex constitution, designate the American Arbitration Association." (Opinion, J.A. 419).

The court based this conclusion on the "mandatory language" of 9 U.S.C. §5 "empowering the court to itself appoint an arbitrator....," and noted that federal courts "have consistently held that arbitration should not be denied 'on the ground of impossibility of following the procedures for designating the arbitrator.'" (Opinion, J.A. 411-412).

It would be ironic in the extreme were this Court to hold that the order below "did not represent an enforcement of the AMEX Constitution according to its terms" (Tr. Br. 49) and thus allow the trustee to escape arbitration entirely. Such a holding would dismember Judge Knapp's specific finding that the AMEX arbitration procedures are applicable and not biased, and would turn his attempt to bend over backward for the trustee's benefit to avoid even the appearance of bias (through use of the AMEX arbitration procedures) into an unwarranted total immunity for the trustee. Yet this is precisely the trustee's position. He seeks to support this theory by reading Section 5 of the Arbitration Act to permit court appointment of substitute arbitrators only in limited cases (Tr. Br. 49-50), overlooking the mandatory language directing district courts to make such an appointment in all cases.

Section 5 provides that if for any reason there shall be an inability in following the designation of the arbitrators by the method selected by the parties in their agreement,

"then upon the application of either party to the controversy the court shall designate"

substitute arbitrators.

The federal courts have consistently held that arbitration should not be denied on the ground of impossbility of following the procedure for designating the arbitrators or arbitration forum. Compania Espanola de Pet. S.A. v. Nereus Shipping S.A., 527 F.2d 966, 975 (2d Cir. 1975); Erving v. Virginia Squires Basketball Club, 468 F.2d 1064, 1067-68 (2d Cir. 1972); Bethlehem Mines Corp. v. United Mine Workers of America, 494 F.2d 726, 730-71, 740 (3d Cir. 1974); Hawaii Teamsters and Allied Workers, Local 996 v. Honolulu Rapid Transit Co., 343 F.Supp. 419, 425 (D. Hawaii 1972).

The trustee, however, would change the applicable federal rule and paint the instant case as follows: where the promise to arbitrate is allegedly so wedded to the precise means of arbitration specified in the applicable contracts, the unavailability of the forum for any reason destroys in it entirety the obligation to arbitrate (Tr. Br., 51-55). First, the theory flies directly in the face both of the mandatory provisions of Section 5 and the Erving decision.* The

* This Court in Erving, in appointing a substitute to replace a specifically designated (but biased) individual arbitrator, rejected the same contention which the trustee makes here on the ground that it would "emasculate arbitration procedures under the federal [Arbitration] act" and would violate the principle that

(Footnote Cont'd)

trustee fails to cite a single federal case in which the unavailability, because of the appearance of bias of otherwise, of a contractually designated arbitrator or arbitration forum was held to negate <u>in toto</u> the obligation to submit all controversies to arbitration.*

Second, assuming contrary to fact that such a rule might exist in federal arbitration practice generally, it could not be applicable to arbitrations between members of the national securities exchanges. The purpose of the arbitration

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(Footnote Cont'd)

> "the federal law is to be implemented in such a way as to make the arbitration effective and not to erect technical and unsubstantial barriers such as were the mode in the early days when arbitration was viewed by many courts with suspicion and hostility." (468 F.2d at 1068, and note 2).

* The two state court cases upon which the trustee relies exclusively (Tr. Br. 51-52) are not governed by Section 5; the law in the federal courts and particularly in this Circuit on this issue is controlling. In any event, in the New York state cases cited by the trustee the courts found that only where specifically named <u>individuals</u> were the designated arbitrators, could the power to appoint substitutes come under attack. However, no similar sui generis naming of particular individuals occurred in this case. <u>Erving</u>, <u>supra</u>, in any event did not consider such specificity an impediment to naming a substitute. Moreover, the trustee's state cases are explained and contrasted in later cases expressive of New York law on this issue. <u>E.g.</u>, <u>Matter of Klines</u>, 2 App. Div. 2d 373 (2d Dep't 1956), <u>aff'd</u>, 3 N.Y.2d 816 (1957); <u>In re Delma Engineering Corp.</u>; 5 N.Y. 2d 852 (1958), <u>affirming</u>, 6 App. Div. 2d 710 (2d Dept. 1958); <u>In re Kingsbrook Jewish Medical Center</u>, 29 N.Y. 2d 854, <u>affirming</u> 37 App. Div. 2d 518 (1st Dept. 1971); and cased cited <u>infra</u> at p. 56.

provisions of the Constitutions of the NYSE and the AMEX was to require arbitration of <u>all</u> disputes between members regardless of whether they could be conducted under the auspices of those exchanges; it was intended to keep <u>all</u> such disputes "out of the courts."

> "The drafters of the New York Stock Exchange arbitration clause intended it to be very broad .... The purpose behind the drafting of such a broad arbitration clause was, as much as possible, to keep disputes between members out of the courts. This policy is entirely consistent with the congressional grant of power to stock exchanges to govern themselves, contained in the Securities Exchange Act of 1934." <u>Coenen v. R.W. Pressprich & Co., Inc., supra</u>, 453 F.2d at 1212.

<u>See also Legg, Mason & Co. v. Mackall & Coe., Inc.</u>, 351 F.Supp. 1367 (D.D.C. 1972).

Indeed, the AMEX Constitution, found applicable by the court below, expressly requires its members (and Walston was one) to arbitrate before the AAA if that election is made by a customer in a dispute between a member and a customer (AMEX Const. Art. VIII, Sec. 2(c)).*

Moreover, the issue of whether the nature of the member-member arbitration provisions in the exchange constitutions goes to the essence of the duty to arbitrate frequently

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* The AMEX Constitution also provides for arbitration before the NYSE if the controversy is between members of that exchange (AMEX Const., Art. VIII, Sec. 2(b)).

has been litigated and all of the cases have been resolved against the trustee's position. E.g., Hirsch v. F.I. duPont, Glore Forgan & Co., Index No. 11514/72 (Sup. Ct. February 1, 1974) (J.A. 285); Fraiman v. F.I. duPont, Glore Forgan & Co., Index No. 23712/72 (Sup. Ct. March 15, 1973) (J.A. 297); Klebanow v. Ira Haupt & Co., Index No. 1105/64 (Sup. Ct. March 18, 1964) (J.A. 302). Thus, in the Klebanow case, an identical argument was made based on the same cases relied upon by the trustee here, and was rejected in the following unequivocal language:

> "Plaintiffs contend that the parties intended arbitration to be limited to a panel of arbitrators chosen in accordance with the Constitution of the Exchange, and that, since this is not possible (because no member of the Arbitration Board is qualified to serve), the provision for arbitration must fall. This contention appears to be without merit.
>
> .... In the instant case, no [particular] arbitrator was named in the arbitration agreement, and there is nothing in the agreement to indicate that if the arbitrators could not all be selected pursuant to the stock exchange constitution, the parties intended that there be no arbitration at all." Slip Op. at pp. 6-7 (J.A. 307-08).

Third, assuming contrary to applicable law that the trustee's "intention" test could have any validity in a case involving member-member disputes, the court below specifically found that the parties intended to arbitrate all disputes regardless of any particular arbitration forum. The court held that (1) the alternative forum provision in the AMEX Constitution

"belies the Trustee's unsupported contention that the identity of the original arbitration tribunal (NYSE or Amex) was so central to the agreement to arbitrate that its unavailability destroys the obligation to arbitrate in its entirety" (Opinion, J.A. 422, note 12);

and (2) the arbitration clause in the Realignment Agreement did not designate an exclusive forum for arbitration, since

"[e]ven a cursory reading of §10.11 [of the Master Agreement] reveals that the parties intended not to limit arbitration to the NYSE but rather to arbitrate all of their disputes regardless of the forum." (Opinion, J.A. 413) (emphasis in original).*

B. The District Court Correctly Enforced the Arbitration Clause In The Master Agreement.

The trustee has relegated to a footnote his argument that Judge Knapp committed "clear error" in concluding that he had the power to enforce the arbitration clause in the Master Agreement (Tr. Br., 48, note 2).

The trustee maintains that the court below, before ordering a stay based on the arbitration clause in the Master Agreement, should have conducted a full trial on the merits regarding the allegations that (a) Walston, under Delaware law, never validly entered into the Master Agreement which contains

* These direct findings put to rest the trustee's bald assertion that Judge Knapp erred by "failing to determine whether Walston was evidencing a general intent to arbitrate...." (Tr. Br. 52).

the arbitration clause; and (b) even if the Master Agreement was valid as a whole, the specific arbitration clause included in that agreement was induced by fraud.

Judge Knapp rejected both prongs of this supposition, holding that (a) under the applicable Supreme Court and Second Circuit cases the validity of the contract as a whole is to be decided by the arbitrators and not the court and (b) the question of fraudulent inducement of the arbitration clause itself based on alleged NYSE misrepresentations was irrelevant, since the NYSE was never intended to be the exclusive arbitration forum (Opinion, J.A. 412-13). Judge Knapp was correct.

The Supreme Court in Prima Paint Corp. v. Flood & Conklin Mfg. Co., 388 U.S. 395, 403-04, (1967) held that in dealing with a Section 3 proceeding for a stay, the sole determination to be made by district courts concerns the making of the contract -- whether the agreement of the parties contains an arbitration clause -- and not questions which affect the validity generally of agreements in which arbitration clauses are embedded.*

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* Assuming the trustee's statement of Delaware Law to be correct, the issue of the validity of the Realignment Agreements will turn on the question of whether those agreements were "fair" (Tr. Br. 48, n. 2). Such a "preliminary" determination is tantamount to a decision on much of the trustee's case on the merits (see complaint ¶¶42-45, 57-59; J.A. 21-23, 37-39, 49). This is precisely the type of determination which the Supreme Court held in Prima Paint, supra, would be improper for any court to make.

In Robert Lawrence Co. v. Devonshire Fabrics, Inc., 271 F.2d 402, 409-10 (2d Cir. 1959), cert. granted, 362 U.S. 909, dismissed under Rule 60, 364 U.S. 801 (1960), this Court clearly determined that the only threshhold issue properly to be decided by a district court is simply whether the parties had entered into an arbitration clause and not whether, based on any claims attacking the merits, the whole contract was invalid. The trustee has for good reason failed to cite this Second Circuit direct precedent -- it destroys the first leg of his theory.*

The second leg incorrectly urges that the trustee is entitled to yet another threshhold trial on the merits -- this time to decide whether the arbitration clause itself, separate and distinct from the Master Agreement in which it is contained, was induced by fraud because of alleged NYSE misrepresentations.**

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* In Kulukundis Shipping Co. v. Amtorg Trading Corp., 126 F.2d 978 (2d Cir. 1942), which is cited by the trustee (Tr. Br. 48), the issue on which the district court made a threshhold determination was whether or not the contract contained an applicable arbitration clause, not whether the contract was in any way void on account of defenses to its total validity. Seventeen years after it decided Kulukundis the Second Circuit dismissed it as a case in which "the defendant denied ever agreeing to anything" Robert Lawrence Co. v. Devonshire Fabrics, Inc., supra, 271 F.2d at 411.

** There is a significant lack of record support for the alleged specific fraud in the inducement of the arbitration clause itself; to the contrary, the record specifically negates the trustee's belated reliance on such NYSE "representations" since in Article 10.12 of the Master Agreement Walston expressly agreed there was no such reliance (J.A. 117-18).

Even a cursory reading of the arbitration clause itself reveals that Judge Knapp correctly ruled that NYSE "fraud" was immaterial, since the parties intended not to limit arbitrations to the NYSE as the exclusive forum, but expressly had a general intention to arbitrate all of their disputes regardless of any particular arbitration forum (see supra at p. 56).* The trustee does not, because he cannot, explain to this Court how the intention to arbitrate on many other securities exchanges (other than the NYSE) as reflected by Section 10.11 of the Master Agreement (Opinion, J.A. 413) can be explained away by any alleged fraud of the NYSE.

IV.

WERE THIS COURT TO DETERMINE THAT THE BANKRUPTCY ACT CLAIMS AND/OR THE SECURITIES LAW CLAIMS ARE NOT PROPERLY THE SUBJECT OF ARBITRATION, THOSE CLAIMS SHOULD BE STAYED PENDING ARBITRATION OF ALL THE OTHER ISSUES

The trustee argues that the court below erred in ordering a stay of the action in favor of the NYSE. The NYSE will file its own brief on this point and we do not address it here. However, in the course of that discussion

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* Indeed, Section 10.11 of the Master Agreement merely contractually codified the parties' pre-existing arbitration obligations as exchange members (Tr. Br. 48), then no fraudulent inducement as to the arbitration clause itself is possible, since one cannot be fraudulently induced to agree to do something he was already bound to do.

in his brief, the trustee also argues in a footnote that if this Court were to rule as to these appellees that the securities or bankruptcy law claims were not arbitrable, it would be improper to stay litigation of those issues pending arbitration of all the other issues (Tr. Br. 56 at note 1).

Assuming arguendo, that this Court were inclined to hold that either the bankruptcy law claims or the securities acts claims are non-arbitrable, the stay of all such claims should nevertheless be maintained pending arbitration of all the other issues in this case. Any other course would bring about the inevitable and unnecessary waste of the resources of the district court, the bankrupt's estate and the defendants, since arbitration will still be required as to all such other issues, and the results of such arbitration might well moot any court proceedings as to the litigable claims (see Opinion, J.A. 418).

Numerous courts have ordered that arbitration precede litigation of non-arbitrable claims. E.g., N.V. Maatschappij Voor Industriele Waarden v. A. O. Smith Corp., 532 F.2d 874, 875-77 (2d Cir. 1976) (hereinafter cited as "A.O. Smith"); A. E. Plastik Pak. Co. v. Monsanto Co., 396 F.2d 710, 716 (9th Cir. 1968); Black v. Econo-Car International, Inc., 404 F.Supp. 600 (D. Mass. 1975); Tepper Realty Co. v. Mosaic Tile Co., 259 F. Supp. 688, 693 (S.D.N.Y. 1966); Younker Brothers, Inc. v. Standard Construction Co., 241 F. Supp. 17,

19 (S.D. Iowa 1965); see Helfenbein v. International Industries, Inc., 438 F.2d 1068, 1070 (8th Cir. 1971); Los Angeles Paper Bag Co. v. Printing Specialties and Paper Products Union, 345 F.2d 757, 760-61 (9th Cir. 1965).

The Arbitration Act, the policies of which the A. O. Smith court was advancing, itself reflects a clear preference for arbitration preceding trial. Under Section 3 of the Act "trial of [any] action" is to be stayed upon the court's determination that there is "any issue referable to arbitration" in accordance with the requirements of the Act. Such a course best promotes the "fundamental purpose of the Federal Arbitration Act . . . [of] . . . reliev[ing] the parties from costly litigation and help[ing] ease congested court dockets." Tepper Realty, supra, 259 F. Supp. at 639, citing Robert Lawrence Co. v. Devonshire Fabrics, Inc., 271 F.2d 402, 410 (2d Cir. 1959).*

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* The Court in Tepper Realty, like Judge Knapp below, clearly explained one rationale for staying all litigation until arbitration is completed, as follows:

> "[the non-arbitrable] claims should be stayed, if not under §3 [of the Arbitration Act], then certainly under our general equity powers, pending arbitration of the dispute between the parties because the negligence claim is grounded on allegations of misfeasance by defendants in the performance of their contracts. The fundamental purpose of the Federal Arbitration Act is to relieve the parties from costly litigation and help ease congested court dockets. That purpose would be thwarted if plaintiffs can escape arbitration by fragmenting a single claim into two 'causes of action' predicated on different legal theories .... These facts alone, we think, call for a stay of the entire action pending arbitration, either under §3 or our general equity powers to control our dockets to relieve this congested court from what may turn out to be an unnecessary law suit." 259 F. Supp. at 693.

The trustee completely ignores this Court's recent pronouncement in A. O. Smith. In affirming a stay of antitrust and patent claims pending arbitration of other claims arising out of the same facts, this Court directly refuted the trustee's contentions and distinguished authorities which supposedly support it.

A. O. Smith readily disposed of the four cases relied upon by the trustee in which courts have ordered the trial of clearly non-arbitrable antitrust claims to precede arbitration (Tr. Br. 61-62).* All four were distinguished in A. O. Smith from the situation present in A. O. Smith (and here), since the non-arbitrable antitrust claims (1) permeated the entire case and (2) had such a clear chance of success, that there would really be nothing left to arbitrate following trial on the antitrust issues. Similarly, in the two non-antitrust cases relied on by the trustee,** the non-arbitrable claims raised factual and legal issues which were either identical to the remaining issues in the case (Shapiro) or the

* American Safety Equipment Corp. v. J. P. Maguire & Co., 391 F.2d 821, 828 (2d Cir. 1968); Ring v. Spina, 148 F.2d 647, 654 (2d Cir. 1945); Varo v. Comprehensive Designers, Inc., 504 F.2d 1103 (9th Cir. 1974); Cobb v. Lewis, 488 F.2d 41, 50 (5th Cir. 1974). There are no non-arbitrable antitrust claims in this case.

** Greater Continental Corp. v. Schecter, 422 F.2d 1100, 1103 (2d Cir. 1970); Shapiro v. Jaslow, 320 F. Supp. 598, 600 (S.D.N.Y. 1970).

decision of which would necessarily moot those remaining issues (Greater Continental). This would not be true in the instant case. Assuming *arguendo* that the trustee's bankruptcy and securities law claims are not arbitrable, they have not been shown to have a clear likelihood of success* nor could litigating those claims moot the rest of the arbitrable issues.

In sum, neither the law nor the facts fit the trustee's desire to subordinate mandated arbitration to litigation.

CONCLUSION

For all the foregoing reasons, the Orders appealed from should be affirmed in all respects.

Dated: New York, New York
September 13, 1976

Respectfully submitted,

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* This is particularly true since the trustee has admitted he has no "personal knowledge of the facts" (Tr. Br. 3) with respect to any claim.

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ADDENDUM OF STATUTORY PROVISIONS

United States Arbitration Act, §§3 & 5, 9 U.S.C. §§3 & 5

§3. Stay of Proceedings Where Issue Therein Referable to Arbitration

If any suit or proceeding be brought in any of the courts of the United States upon any issue referable to arbitration under an agreement in writing for such arbitration, the court in which such suit is pending, upon being satisfied that the issue involved in such suit or proceeding is referable to arbitration under such an agreement, shall on application of one of the parties stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement, providing the applicant for the stay is not in default in proceeding with such arbitration.

§5. Appointment of Arbitrators or Umpire

If in the agreement provision be made for a method of naming or appointing an arbitrator or arbitrators or an umpire, such method shall be followed; but if no method be provided therein, or if a method be provided and any party thereto shall fail to avail himself of such method, or if for any other reason there shall be a lapse in the naming of an arbitrator or arbitrators or umpire, or in filling a vacancy, then upon the application of either party to the controversy the court shall designate and appoint an arbitrator or arbitrators or umpire, as the case may require, who shall act under the said agreement with the same force and effect as if he or they had been specifically named therein; and unless otherwise provided in the agreement the arbitration shall be by a single arbitrator.

The Securities Exchange Act of 1934, §28(b), 15 U.S.C. §78bb(b)

(b) Nothing in this chapter shall be construed to modify existing law with regard to the binding effect (1) on any member of or participant in any self-regulatory organization of any action taken by the authorities of such organization to settle disputes between its members or participants, (2) on any municipal securities dealer or municipal securities broker of any action taken pursuant to a procedure established by the Municipal Securities Rulemaking Board to settle disputes between municipal securities dealers and municipal securities brokers, or (3) of any action described in paragraph (1) or (2) on any person who has agreed to be bound thereby.

New York Stock Exchange Constitution, Article VIII, §1

Any controversy between parties who are members, allied members, member firms or member corporations shall, at the instance of any such party, and any controversy between a non-member and a member or allied member or member firm or member corporation arising out of the business of such member, allied member, member firm or member corporation, or the dissolution of a member firm or member corporation, shall, at the instance of such non-member, be submitted for arbitration, in accordance with the provisions of the Constitution and the rules of the Board of Directors.

American Stock Exchange Constitution, Article VIII, §1

Members, member firms, partners of member firms, member corporations and officers of member corporations shall arbitrate all controversies arising in connection with their business between or among themselves or between them and their customers as required by any customer's agreement or, in the absence of a written agreement, if the customer chooses to arbitrate.

Master Agreement to The Realignment Agreements, Article 10.11

Arbitration. duPont and Walston agreed to submit any dispute arising under this Agreement and the Ancillary Agreements or with respect to any of the transactions contemplated thereby to arbitration, in accordance with the provisions of the Constitution of the NYSE and the Rules of the NYSE, except that disputes under the Clearing Agreement relating to transactions executed on an exchange other than on the NYSE, which has in its constitution or rules provisions compelling arbitration among members thereof, shall be submitted to arbitration in accordance with the Constitution and Rules of such other exchange.

STATE OF NEW YORK)
SS.:
COUNTY OF NEW YORK)

Dolores Griffin being duly sworn, deposes and says, that deponent is not a party to the action is over 18 years of age and resides at 86-26 208th Street, Queens Village, New York. That on the 13th day of September, 1976, deponent served two copies of the within Brief of Defendants-Appellees (other than the New York Stock Exchange, Inc.) upon the attorneys listed below

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by depositing same enclosed in a postpaid properly addressed

wrapper, in an official depository under the exclusive care and custody of the United States post office department within the State of New York.

Dolores Griffin

Dolores Griffin

Sworn to before me this

13th day of September, 1976.

Notary Public

HAROLD F. BONACQUIST
Notary Public, State of New York
No. 31-4625433
Qualified in New York County
Commission Expires March 30, 1978